LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
http://www.in.gov/legislative

FISCAL IMPACT STATEMENT

LS 6439 | **NOTE PREPARED:** Dec 10, 2002
BILL NUMBER: HB 1318 | **BILL AMENDED:**

SUBJECT: Elimination of Taxation of Savings Accounts.

FIRST AUTHOR: Rep. Kruse | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: <u>X</u> **GENERAL** | **IMPACT:** State & Local
<u>X</u> **DEDICATED**
FEDERAL

<u>Summary of Legislation:</u> The bill eliminates state and local income taxes on interest paid by financial institutions on savings accounts and certificates of deposits held by individuals.

<u>Effective Date:</u> January 1, 2004.

<u>Explanation of State Expenditures:</u> The Department of State Revenue (DOR) would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate this deduction. These expenses presumably could be absorbed given the DOR's existing budget and resources.

<u>Explanation of State Revenues:</u> The bill would reduce state Adjusted Gross Income (AGI) Tax liabilities of individual taxpayers who have interest earnings from savings accounts and certificates of deposit (CDs). The revenue loss due to this bill could potentially range from $76.0 M to $87.0 M annually beginning in FY 2005.

Background: The bill provides an AGI Tax deduction for interest earned from: (1) a CD issued by a financial institution; or (2) money in a savings account that is on deposit at a financial institution that is included in the taxpayer's federal Adjusted Gross Income (Federal AGI). Since the deduction is effective beginning in tax year 2004, the fiscal impact would begin in FY 2005. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund.

Taxable interest earnings included in Federal AGI by Indiana residents exceeded $3,000.0 M each year from

1996 to 2000 (the most recent year for which data is available). During this period, taxable interest earnings of Indiana residents, on average, totaled $3,203.8 M. The totals during this period ranged from $3,047.5 M in 1996 to $3,454.7 M in 2000. However, these totals are not entirely attributable to interest earnings from savings accounts and CDs. Thus, these totals are adjusted based on a national estimate of taxable interest earnings attributable to savings accounts and CDs. Savings and CD interest earnings nationally are estimated to represent, on average, from 70% to 80% of the taxable interest earnings included in Federal AGI. This range is based on the 1995-1999 average for savings and CD interest earnings estimates utilizing interest rates for Treasury Bills and Bank CDs. These percentages are applied to the reported taxable interest totals for Indiana residents. Based on the average, taxable interest of Indiana residents that is attributable to savings accounts and CDs could potentially total about $2,233.9 M to $2,551.1 M in a given tax year. Deduction of these amounts from Indiana taxable income would lead to a revenue loss of approximately $76.0 M to $87.0 M.

It is important to note that revenue loss estimates varied from about $70.0 M to as much as $95.0 M depending upon the yearly average interest rates, savings and CD totals, and reported taxable interest earnings totals employed in the estimation process. It is also important to note that interest earnings attributable to savings accounts and CDs could potentially be lower in the next year or two given the significant decline in interest rates over the last two years relative to the period analyzed. The rates used in the analysis have experienced a decline of about 71% since 2000. However, prior declines in interest rates (from 1991-1993 and 1995-1998) did not coincide with proportionate declines in taxable interest earnings. Thus, the influence that recent interest rate declines and current historical low interest rates might have on the potential impact of this deduction is indeterminable, and potentially short lived.

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the proposed deduction would serve to decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience a significant decrease in revenue from these taxes. The precise amount of the decrease, however, is indeterminable.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: Internal Revenue Service, *Statistics of Income Bulletin*; Federal Reserve Bank of St. Louis, *Federal Reserve Economic Data*.

Fiscal Analyst: Jim Landers, 317-232-9869